THE BERKSHIRE GAS COMPANY

Direct Testimony of Karen L. Zink

D.T.E. 04-47

Q. Please state your name, employer and business address.

A. My name is Karen Zink. I am employed by The Berkshire Gas Company ("Berkshire" or the "Company") and my business address is 115 Cheshire Rd., Pittsfield, MA 01201.

Q. What is your position with Berkshire?

A. I am President, Chief Operating Officer and Treasurer.

Q. Could you please briefly describe your educational and professional background.

A. Yes. I graduated from Central Connecticut State University in 1979 with a Bachelor of Science degree in Finance and from Western New England College in 1997 with a Masters of Business Administration. I have held several positions with the Company including Supervisor of Financial Services, Supervisor of Planning, Manager of Rates and Planning, Director of Rates, Regulation and Resource Planning, Vice President of Marketing and Resource Planning, and Vice President and General Manager. I was promoted to my current position on May 1, 2004.

Q. Please summarize your responsibilities as President, Chief Operating Officer and Treasurer.

A. As President, Chief Operating Officer and Treasurer, I have responsibility for all aspects of the Company's operations. In my earlier positions I had more direct responsibility for marketing, rates, gas supply, gas dispatch, transportation services, demand-side management programs, and long-range strategic planning and forecasting. In particular, I have been involved in negotiating and securing Department approval for earlier iterations of similar arrangements to those before the Department in this proceeding.

Q. Have you testified as a witness in any other proceedings involving the Company before this Department?

A. Yes. I testified as a witness in the Company's last three base rate cases regarding rate design, revenue and weather normalization, and a price-cap mechanism (D.P.U. 90-121; D.P.U. 92-210; and, D.T.E. 01-56). Further, I actively participated in the Massachusetts Gas Collaborative effort in developing model terms and conditions pursuant to D.T.E. 98-32 and D.T.E. 00-13, and sponsored the Company's unbundled rate initiative in D.T.E. 98-65. Also, I have testified as a witness on many gas supply related issues including the Company's requests for approval of a LNG supply contract (D.T.E. 98-110); for approval of a pipeline gas supply (D.T.E. 02-81); for approval of the Company's Forecast and Supply Plan (D.T.E. 98-99 and D.T.E. 02-17); for approval of the Company's seasonal cost of gas adjustment revision (D.T.E. 01-10); for approval of a financing plan involving the issuance of debt securities (D.T.E. 03-89); and for approval of the Company's alliance arrangements between BP Energy Company ("BP Energy") and the Energy East Corporation gas distribution companies, including Berkshire (D.T.E. 01-41 and D.T.E. 02-19).

Q. Please describe the various industry groups of which you are a member.

A. I am a member of the Northeast Gas Association, previously served on the general Board of Directors, and was the Chairperson of the Board of Directors of the Marketing Division. I also served for several years as Chairperson of the Planning and Rates Committee. Finally, I am a member of the Guild of Gas Managers.

Q. What is the purpose of your testimony?

A. I am pleased to describe to the Department the benefits associated with the Company's most recent Gas Portfolio Optimization Agreement with BP Energy and the related Gas Purchase and Sale Agreement (collectively, the "2004 Optimization Agreements"), which replace and enhance the relationship with BP Energy and reflect some modifications to similar agreements approved in D.T.E. 02-19 ("2002 Optimization Agreements"). The 2004 Optimization Agreements reflect the "third generation" of the alliance with BP Energy. The first version of the Gas Portfolio Optimization Agreement and Gas Purchase and Sale Agreement were executed in 2001 for a one-year term and were reviewed and approved by the Department in D.T.E. 01-41 (the "2001 Optimization Agreements"). The 2002 Optimization Agreements were executed March 28, 2002 and covered a two-year term ending March 31, 2004. As noted, the 2002 Optimization Agreements were reviewed and approved by the Department in D.T.E. 02-19. This testimony provides background concerning the results of operations under the 2002 Optimization Agreements, an update on BP Energy, an overview of the current market, the Company's solicitation processes that resulted in the execution of or enhancements in the 2004 Optimization Agreements, and describes key elements of or enhancements in the 2004 Optimization Agreements.

Q. Please provide an overview of the existing BP Energy relationship.

A. On March 22, 2004, Connecticut Natural Gas Corporation ("CNG"), The Southern Connecticut Gas Company ("SCG"), New York State Electric & Gas Corporation ("NYSEG"), Rochester Gas and Electric Corporation ("RG&E") and Berkshire (collectively the "LDCs" who are regulated gas distribution subsidiaries of Energy East Corporation ("Energy East")), each entered into agreements with BP Energy that are essentially identical to the 2002 Optimization Agreements. The 2004 Optimization Agreements reflect the first year that RG&E has participated in the alliance. Maine Natural Gas Company, a smaller affiliated company, also receives some supply-related services from BP Energy but does not directly participate in optimization activities.

The 2004 Optimization Agreements maintain the core principles of the 2002 Optimization Agreements and the 2001 Optimization Agreements. Under the 2004

Optimization Agreements, the LDCs continue to retain full control of their gas supply, pipeline transportation, gas storage, produced gas and related assets. The 2004 Optimization Agreements are designed to enhance the use of the Company's natural gas portfolio relating to transportation, storage, and the purchase and sale of natural gas, while simultaneously continuing to provide customers with least-cost, reliable service. This is accomplished by working together with BP Energy, which brings complementary market and wellhead knowledge and expertise. The team of individuals that represent the Energy East LDCs and BP Energy will work with the shared goal of replicating the least-cost routing and reliability present under a least-cost dispatch of supplies, maintaining or enhancing existing levels of reliability while adding incremental value by optimizing the use of the LDCs portfolios consistent with the Company's portfolio objectives. This team or alliance approach allows the LDCs to maintain the appropriate level of control of their assets and provides the LDCs with a unique approach to maintain and develop internal capabilities while leveraging the expertise of BP Energy, a recognized leader in the industry. Importantly, Berkshire and the other LDC's are able to continue to build upon the experience gained pursuant to the 2002 Optimization Agreements and the 2001 Optimization Agreements.

Q. Please provide an update on BP Energy.

A. BP Energy is the largest producer and reserves holder of natural gas in North America. BP Energy's supply resources are located in key areas relative to the Company's supply, transportation and storage resources. BP Energy also maintains substantial technological and risk management expertise that continues to be made available to the Company. BP Energy is very familiar with the Company's resources and the Company's staff is familiar with the transactions and opportunities that may be pursued pursuant to the alliance structure. The Company believes that these factors enhance the prospect for continuing success pursuant to the restructured alliance.

Q. Please describe the experience and successes with BP Energy under the current relationship.

A. The Company has been pleased with the performance of the BP alliance, especially during this time of changing market conditions. In a marketplace with more limited opportunity for gas optimization savings, substantial results were nevertheless achieved. The alliance has also provided an excellent opportunity for the Energy East companies to implement joint gas supply activities. Further, the alliance has provided a cross-training vehicle for our own personnel broadening overall internal knowledge and understanding of the complex natural gas market. This access to information has provided the Company with key insights into issues related to natural gas commodity supply and pricing.

[SUBJECT TO CONFIDENTIALITY]

Q. Please describe what you mean by "changing market conditions" in your last answer.

A. The last few years have been extremely volatile for natural gas markets. From a commodity standpoint the last several years have featured wide variations in prices. We have also experienced a wide range of weather conditions, including extended periods of high demand such as January 2004 where little if any opportunity existed for optimization transactions. Importantly, Berkshire did not experience any reliability concerns during this period and believes that the ability to provide such reliable service is enhanced through participation in the alliance. From a broader perspective, the substantial credit challenges facing the energy industry have had a substantial effect. For example, several primary market-makers for many types of commodity and financial transactions related to natural gas have failed and their withdrawal substantially reduced market liquidity for many transactions. Importantly, neither BP Energy nor Energy East were specifically impacted by this situation, beyond the overall impact on the energy industry.

Q. How do "changing market conditions" affect optimization?

A. Optimization values are directly affected by market conditions. When natural gas prices, transportation values, price volatility and price spreads are low (i.e., caused by mild weather, high levels of natural gas in storage, low demand, high production, etc.) or if natural gas is priced unfavorably compared to alternate fuels, the level of savings available from optimization is reduced. However, such market conditions usually result in a period of low commodity prices which directly benefits the Company's customers. These conditions were present during substantial portions of the previous agreement term and resulted in fewer opportunities for optimization savings. At the same time, this resulted in lower gas prices and direct savings for Berkshire's customers as described previously in my testimony. Alternatively, during periods of extreme cold, there are limited opportunities for optimization as reliability is typically a paramount concern, such as was experienced this past winter.

Q. Please describe the events that led to the decision to execute the 2004 Optimization Agreements.

A. The central basis for structuring the solicitation that resulted in the execution of the 2004 Optimization Agreements was the reliance upon our substantial experience with solicitations for similar services. For example, while the Company responded to a directive in D.T.E. 01-41 to conduct a company-specific solicitation to replace the 2001 Optimization Agreements, this same condition was not imposed in D.T.E. 02-19. In fact, Berkshire recognized the limited response to that company-specific request for proposals for portfolio services in connection with the analysis of the renewal or modification of the 2001 Optimization Agreements and determined that such effort was not in the best interest of customers. Consequently, the Energy East companies issued a Request for Proposals ("Joint RFP") on a combined basis on November 13, 2003 to engage in a transparent and robust bidding process. This enabled the Companies to determine how other service providers viewed the market and would structure their bids. Based on this transparent process, the Energy East companies could see whether such other companies or BP Energy provided them with the best opportunity to maximize optimization savings for their customers.

In December 2003 the Energy East companies received responses to the Joint RFP from eleven (11) large energy companies including BP Energy. The Joint RFP responses clearly reflected then-current market conditions. During that span of time wellhead prices had risen while transportation values and market spreads had diminished. Despite the changing market conditions, the companies were able to select four (4) respondents for a short-list discussion, including BP Energy. After the short-list proposals were evaluated and meetings were held, it was clear that BP Energy's proposal surpassed alternative proposals and offered the best opportunity for the Company. This fact, coupled with BP Energy's experience working with the LDCs and the systems that had been put into place, made BP Energy the final candidate for negotiation. After intense negotiations the LDCs selected BP Energy to continue to work with them to add incremental value for their customers, and entered into the 2004 Optimization Agreements.

Q. Please summarize why the BP Energy alliance is the best choice going forward.

A. BP Energy represents an excellent partner with financial strength, history and sound business values. BP Energy is the best choice because the alliance continues to:

a) provide the best opportunity to achieve further reductions in the cost of gas for the Company, an opportunity that is substantially superior to other market offerings as determined by two comprehensive, competitive solicitations;

b) allow the Company the ability to capitalize on the benefits from a larger gas portfolio made available through the Energy East merger;

c) reinforce reliability of service;

d) complement and supplement existing in-house expertise;

e) increase the existing skill-set and in-house capabilities;

f) assist in risk management and price stability;

g) provide exposure to broader markets; and

h) allow the Company to retain control over its individual assets and resource portfolio.

Under the 2004 Optimization Agreements, the Company will continue to control, own and operate its natural gas portfolio while accessing and leveraging the unique expertise of the alliance members. Access to BP Energy's substantial and diverse natural gas production and resources enhances reliability. Access to BP Energy's broad expertise and market knowledge also assists in decisions related to reducing the commodity cost of gas. Further, the combined capabilities of the alliance are expected to continue to produce results from asset optimization activities that exceed those available absent the alliance. [SUBJECT TO CONFIDENTIALITY]

Q. Please summarize the 2004 Optimization Agreements.

A. The basic principles of the 2004 Optimization Agreements remain unchanged from the 2002 Optimization Agreements and the 2001 Optimization Agreements. Under the 2004 Optimization Agreements the Company will continue to:

1. [SUBJECT TO CONFIDENTIALITY] ;
2. retain full control of its gas supply, transportation and storage assets;
3. retain full control of all downstream resources such as liquefied natural gas;
4. have access to various price stability tools; and
5. purchase commodity on a least-cost basis, which will allow for continued access to pricing under existing supply contracts that contain lower prices.

The major differences in the 2004 Optimization Agreements from the 2002 Optimization Agreements are:

1. the term will be for a three-year period commencing on April 1, 2004;
2. [SUBJECT TO CONFIDENTIALITY] ; and
3. [SUBJECT TO CONFIDENTIALITY]

Q. Please describe the basis for a three-year term.

A. After concluding the Joint RFP process, and with our experience with BP Energy over the last three years, the Energy East companies supported a three-year term. Given that under the 2004 Optimization Agreements Berkshire will still control its gas portfolio assets and the 2004 Optimization Agreements reflect the most attractive market opportunity that will result in least cost gas to the Company's customers, Berkshire decided that the more favorable three-year term was appropriate. In addition, a three-year term provides continuity and the ability to have optimization deals which extend beyond or straddle a longer period, and avoids the start-up issues associated with a new alliance partner.

Q. Please describe the Company's proposal for applying the margins for savings generated pursuant to the 2004 Optimization Agreements?

A. In the course of presenting arguments on brief in D.T.E. 02-19, the Company stated its views on "margin sharing" consistent with the principles established in Interruptible Transportation/Capacity Release, D.P.U. 93-141-A (1996). The Department's decision noted that it would remain open to consider a separate petition for cost recovery of margins pursuant to the 2002 Optimization Agreements. This testimony summarizes the Company's views and its request that the Department consider and approve the Company's proposed treatment of alliance margins under the 2004 Optimization Agreements.

D.P.U. 93-141-A established an incentive structure for certain "optimization" transactions such as interruptible sales, capacity release ("CR") interruptible transportation and off-system sales. Berkshire submits that, as recognized in D.T.E. 01-41, p. 11, the alliance agreements really address "consulting services." Berkshire maintains "control of its dispatch decisions on a daily basis." Id. at 13. Berkshire pursues the very same type of transactions described in D.P.U. 93-141-A often following the advice procured through the alliance. Thus, the optimization transactions pursued through the alliance may properly be classified as one of these established transactions. Therefore, the Department could simply apply its established margin sharing principles to the savings generated with the benefit of alliance assistance. In fact, this same approach with respect to margin sharing has been applied to other "vehicles" pursued by gas companies such as asset management agreements. Alternatively, Berkshire submits that the Department should apply the established formula (a 25/75 split of the increased savings from the prior year) to the alliance structure on an aggregate basis. This margin opportunity would provide an appropriate and equitable incentive while remaining consistent with established Department guidelines.

Q. Why is such margin sharing appropriate?

A. Margin sharing provides a strong and appropriate incentive to be as creative as practicable with respect to optimizing the Company's portfolio that, in fact, provides substantial benefits to customers. Indeed, the Department encouraged LDC's to "consider seriously more aggressive capacity releases." D.P.U. 93-141-A, p. 61. Berkshire has worked hard and creatively to secure a structure that contributes to lower gas costs. Absent the application of established margin sharing principles to the alliance structure Berkshire would, in effect, be denied any reward for its aggressive pursuit of optimization opportunities. Indeed, the effect would be to punish Berkshire as compared to other gas companies for pursuing a beneficial, innovative structure that secures merger-related synergies for the benefit of customers. LDC's that do not pursue such opportunities could, however, still earn margins even though providing less benefits to customers. In sum, Berkshire believes that the Department should confirm that these established principles apply to the transactions pursued by Berkshire with the assistance of its alliance participants and approve its margin sharing proposal of assigning alliance transactions to the Department's established categories or, alternatively, consider alliance savings on an aggregate basis.

Q. Why should the Department approve the 2004 Optimization Agreements?

A. The existing BP Energy alliance has provided substantial savings and other benefits. A continuing partnership with BP Energy, the largest producer and reserves holder of natural gas in North America, a financially strong company with solid and ethical business values, is desirable. The 2004 Optimization Agreements maintain the principles, control and flexibility of the original agreements that were approved in D.T.E. 01-41 and D.T.E. 02-19, and allow the Company to reap the benefits of the expertise of a nationally recognized energy expert, while minimizing the risks. Moreover, the Company aggressively tested the market for alternative opportunities and concluded that the 2004 Optimization Agreements were the best options considering both price and non-price factors. In sum, the solicitation process was robust and transparent and helped to identify the most attractive opportunity available to the Company. The 2004 Optimization Agreements will enable the Company to continue to achieve its portfolio objective of securing a least cost, reliable gas supply for the benefit of customers. Finally, the application of established margin sharing principles is appropriate and equitable.

Q. Does this conclude your testimony?

A. Yes.